



Federal Emergency Management Agency

Washington, D.C. 20472

JUL 29 1987

MEMORANDUM FOR: Chief Executive Officer

FROM:

Harold T. Puryear
Harold T. Puryear, Administrator
Federal Insurance Administration

SUBJECT:

Community Rating System under the National
Flood Insurance Program

The Federal Insurance Administration recently published in the Federal Register an Advance Notice of Proposed Rulemaking which stated its intentions of developing a community rating system for the National Flood Insurance Program (NFIP).

While the Federal Register publication requested comments by August 30, you may not have seen that legal notice. We have attached a copy of the Federal Register for your information and we encourage your input on the proposal. The goal of the Community Rating System is to use flood insurance premium adjustments to encourage community and State activities not required by the NFIP Federal regulations, that will:

1. Reduce flood losses,
2. Facilitate accurate insurance rating, and
3. Promote the awareness of flood insurance.

In implementing this proposed system, other considerations will be:

1. Community and State participation will be voluntary.
2. Activities to be recognized must be readily identifiable, observable and objectively measurable.
3. The system must be revenue neutral to the NFIP average insurance rate level.
4. The benefits of the system must be greater than the administrative costs.

In advance the Federal Insurance Administration appreciates any comments or suggestions you wish to make on the Community Rating System. We would respectfully request the following format:

1. Description of Community Activity
2. Identification of community in which this activity is currently being performed.
3. Recommendation on the criteria for evaluating community performance.
4. Recommendation on how the FIA could estimate the benefits of community activity.

Attachment

**FEDERAL EMERGENCY
MANAGEMENT AGENCY****44 CFR Part 61****National Flood Insurance Program;
Rating System Changes**

AGENCY: Federal Emergency
Management Agency (FEMA).

ACTION: Advance notice of proposed
rulemaking.

SUMMARY: The Federal Emergency Management Agency (FEMA) is interested in developing two kinds of rating system improvements for use in the National Flood Insurance Program (NFIP): A community rating system that grades a community's flood plain management for use in determining the flood insurance rates to be applied in calculating the premiums for properties located in that community, and a system to use a community's current Flood Insurance Rate Map (FIRM) for rating of insurance, subject to a rate ceiling if the building was built in compliance with the flood plain management requirements in effect at the time of original construction and at the time of any substantial improvement.

Since 1981, the Federal Insurance Administration (FIA) has taken the position that insurance rates should provide an economic incentive to property owners to reduce risk. Discounts on flood insurance rates for a property owner in a community that has

adopted effective flood plain management programs that provide the type of information and enforcement needed to reduce future flood damage would appear to be justified. In 1983, the FIA published its long range plan for becoming actuarially sound. The section of the plan designed to promote reduction of flood damage to buildings and their contents called for development in 1987 of a system of rating communities on the basis of their record of flood plain management. The community rating system would be designed to recognize circumstances within local communities that mitigate or might exacerbate the flood risk, such as the performance of a community that goes beyond minimum NFIP floodplain management requirements or, on the other hand, inaction of a community in addressing flood problems.

The use of current FIRM's in the rating of insurance applied for after the effective date of the current FIRM for coverage on a building built prior to the effective date of the current FIRM would enable the NFIP to replace the current practice of allowing the premium for such properties to be based on the FIRM in existence at the time of construction as long as the construction met the flood plain management requirements in force at that time. The increasing administrative expenses that would result from maintaining an insurance rating system dependent upon insurance agents and communities retaining available historical versions of FIRM's that would extend over many decades do not appear to be warranted. However, a ceiling on the flood insurance rates to avoid the application of unreasonably high rates would appear to be reasonable and would reduce future operating expenses of insurance agents, communities and the government.

DATE: Comments must be received on or before August 31, 1987.

ADDRESS: Send comments to the Rules Docket Clerk, Office of General Counsel, Federal Emergency Management Agency, 500 C Street SW., Washington, DC 20472.

FOR FURTHER INFORMATION CONTACT: Francis V. Reilly, Federal Insurance Administration, Federal Emergency Management Agency, 500 C Street SW., Washington, DC 20472; telephone number (202) 646-2782.

SUPPLEMENTARY INFORMATION: FEMA's goal for the NFIP continues to be achieving a fiscally sound insurance program that promotes the public interest by providing appropriate protection against flood losses and by encouraging sound flood plain

management that minimizes exposure of property to flood losses.

Over the past six years, FEMA has had made a series of insurance rate changes and has implemented changes in the coverage of the insurance policy itself. Pricing the insurance to reflect the risk creates a direct economic incentive for the property owner or developer to consider the flood risk potential prior to construction or substantial improvement of the building (the greater the risk, the greater the direct flood insurance cost to the property owner). This type of direct economic incentive has brought about a new focus on the flood problem associated with the improper use of the nation's flood plains and unsafe building practices. Thus, the program has been strengthened, thereby making it more effective in advancing the goal of flood loss reduction.

Community Rating

For community rating, FEMA plans to establish a system that grades a community's flood plain management for use in determining the flood insurance rates to be applied in calculating the premiums for properties located in that community. This system will not require a detailed assessment of each property's unique circumstance but will recognize communitywide actions that reduce future flood damage to buildings and their contents.

The NFIP currently uses countrywide classifications of risk in determining flood insurance rates. However, within local areas there may be circumstances that can mitigate or exacerbate that risk. These circumstances include hazards unique to an area, the inaction of a community in addressing flood problems, and the performance of a community that goes beyond minimum NFIP flood plain management requirements. It is postulated that dollar savings to a community's citizens purchasing flood insurance will provide community officials with an incentive to adopt local programs to reduce the community's future exposure to flood. A system of this type has been in effect many years for fire insurance protection and is considered successful. Because it is not practical to reflect these factors contributing to the risk assessment of an individual basis while rating policies, FEMA will be exploring a rating system that will:

(1) Foster community actions that will reduce the growing Federal exposure to economic loss resulting from insurance claims payments and tax write-offs, and reduce the need for disaster relief for communities and individuals;

(2) Minimize unknowns, such as urban drainage problems affecting areas not

identified as special flood hazard areas on the community's FIRM, that might increase the aggregate amount of potential flood damage in the community; and

(3) Facilitate the accurate insurance rating of properties in the community.

Use of Current Maps for Rating

FEMA plans to establish a rating system that relies on current Flood Insurance Rate Maps (FIRM's) and that provides a rate ceiling in those instances where the property owner can provide reasonable evidence that (1) the building has not been altered in a manner that caused its current adverse rating and (2) the building complied with the program requirements when it was constructed. The rate ceiling should be sufficiently high so that only those properties that are extremely adversely affected by FIRM revisions will be submitted for eligibility determination. In this manner the need for individual risk rating based on old risk criteria could be eliminated.

The National Flood Insurance Act of 1968, as amended, provides for the use of subsidized rates in lieu of full risk premium rates in the determination of insurance premiums for buildings constructed or substantially improved prior to the effective date of the initial FIRM or January 1, 1985, whichever is later, and the contents located therein.

Since 1970, the NFIP has established two categories of subsidized rates: Emergency Program rates made effective under the rulemaking process that can be applied to all construction and substantial improvement started prior to either the effective date of the initial FIRM or January 1, 1975, whichever is later; and individual property rates when it is determined that the construction initially adhered to or exceeded the NFIP requirements in effect at the time of construction but subsequent revisions of the FIRM have changed the risk zone and/or the elevation requirement. The administration of individual property risk rates for changed risk conditions relies on the availability of community records and the availability of old FIRM's. As time passes, the availability of these old records becomes less certain, and with the ever increasing flood potential the taxpayer subsidy also increases.

Comments

Comments are solicited on the advisability of undertaking these changes and on ways to undertake them. All comments received will be given careful consideration and addressed in any proposed rulemaking

or other action necessary for their implementation.

Impacts

FEMA has determined, based upon an Environmental Assessment, that the proposed rule likely to result from this advance notice of proposed rulemaking would not have a significant impact upon the quality of the human environment. The Environmental Assessment and a finding of no significant impact are included in the formal docket file and are available for public inspection and copying at the Rules Docket Clerk, Office of General Counsel, Federal Emergency Management Agency, 500 C Street, SW., Washington, DC 20472.

The regulations likely to result from this advance notice of proposed rulemaking would not have a significant economic impact on a substantial number of small entities, and, hence, no regulatory flexibility analysis has been prepared.

The rule likely to result from this advance notice of proposed rulemaking would not be a "major rule" as defined in Executive Order 12291, dated February 17, 1981, and, hence, no regulatory analysis has been prepared.

FEMA has determined that the proposed rule likely to result from this advance notice of proposed rulemaking would not contain a collection of information requirement as defined in section 3502 of the Paperwork Reduction Act.

List of Subjects in 44 CFR Part 61

Flood insurance.

Authority: 42 U.S.C. 4001 et seq.;
Reorganization Plan No. 3 of 1978; E.O. 12127.

Dated: June 17, 1987.

Harold T. Duryee,

Federal Insurance Administrator.

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